



ELECTRONIC DISCLOSURE ISSUE BRIEF

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Disclosure protects the interests of the bondholder and the issuer. The more information readily available to the market, the more efficiently bonds will be priced. Issuers of municipal securities are beginning to use the Internet to provide disclosure information about the entity and their outstanding bonds, as well as new offerings of their securities.

The California Debt and Investment Advisory Commission (CDIAC) recently published an Issue Brief on Electronic Disclosure. This Issue Brief provides the following information:

- a summary of Securities and Exchange Commission (SEC) disclosure requirements and a discussion of ways the bond community utilizes electronic disclosure to supplement and/or meet disclosure requirements;
- a discussion of the SEC's recently published Interpretation on the use of electronic media, as well as a description of how this Interpretation was received by the bond community; and
- a presentation of a number of recommendations that issuers should consider when contemplating an electronic disclosure program or fine tuning an existing program.

Appendices provide more detail on SEC disclosure rules and references on the topic of municipal disclosure. This article summarizes the key topics covered in this Issue Brief. The full document can be found at CDIAC's web site www.treasurer.ca.gov/cdiac. For more information, also see the Government Finance Officers Association's recommended best practices for using a web site for disclosure, located at www.gfoa.org/services/rp/debt.shtml#20.

SEC Disclosure Requirements and Uses of Electronic Media to Address these Requirements

For initial disclosure, SEC Rule 15c2-12 generally requires an underwriter to review and to distribute to investors copies of the issuer's preliminary official statement (POS) and final official statement (OS). For continuing disclosure, the SEC requires underwriters, in order for them to purchase and sell these securities, to determine that the

issuer has undertaken a written agreement to provide continuing disclosure information (such as annual financial statements and material event notices).

Over the last few years, underwriters and issuers have turned to the Internet as a supplement to the more traditional distribution of disclosure documents via the U.S. mail. For instance, many underwriters now use e-mail to distribute an OS to an investor. Some issuers also use their web sites to post an OS as a way to provide direct access to investors. In addition, some issuers also are providing continuing disclosure information (such as financial statements) on their web sites or on third-party web sites.

On April 28, 2000, the SEC published guidance in the form of an Interpretation, entitled Use of Electronic Media [File No. S7-11-00]. The Interpretation clarified previous SEC Interpretations that dealt with the dissemination of investor material via electronic media. The Interpretation kept this foundation in place but clarified certain regulatory issues relating to electronic delivery.

SEC Interpretation: Use of Electronic Media

There are several key consent mechanisms relating to the electronic delivery of information – informed consent, global consent, implied consent, and access-equals-delivery. The SEC Interpretation clarifies that informed consent could be obtained via telephone if a record of the consent is retained and specifies that global consent could be obtained only through a separate agreement and not by imbedding it in a standard account-opening agreement. In

Consent Mechanisms

Informed consent - the investor provides the underwriter with explicit consent for the electronic delivery of the information.

Global consent – the investor consents to the electronic delivery of all documents by or on behalf of a single issuer or underwriter.

Implied consent - the investor does not affirmatively object when notified of the issuer's or intermediary's intention to deliver documents in an electronic format.

Access-equals-delivery – the investor would be assumed to have access to the Internet, thereby allowing delivery to be accomplished solely by an issuer posting a document on a web site.

addition, the Interpretation states that investors cannot be assumed to have access to the Internet, which would have allowed delivery of a document by posting it on an issuer web site (access-equals-delivery), and states that issuers cannot infer that investors want documents delivered electronically when they do not object to a notification of intended electronic delivery.

The SEC also looks at the use of various electronic media such as hypertext markup language (HTML) and portable document file (PDF) formats. The Interpretation states that disclosure documents in the PDF format can be posted to issuer web sites if the issuer informs investors how to download these documents and provides software and technical assistance at no cost.

The envelope theory, which maintains that documents in close proximity to one another on a web site are considered delivered together, is also discussed. The SEC states that information on a web site becomes part of an OS only if an issuer or underwriter acts to make it part of the OS.

Lastly, the Interpretation discusses the issue of web site content, which involves issuer responsibility for content on or hyperlinked with its web site. Specifically, the SEC asserts that there are several factors that must be considered when deciding whether an issuer has “adopted” information on a third-party web site linked to the issuer’s web site. The SEC also states that some litigants in private lawsuits are contending that disclosure

documents on web sites are “republished” each time they are accessed, thus must be constantly updated with current information to avoid being inaccurate or misleading.

Recommendations

In light of the SEC Interpretations and differing opinions regarding the implementation of electronic disclosure, CDIAC recommends that municipal issuers consider the following practices when contemplating an electronic disclosure program or fine-tuning an existing program:

- **Establish an investor relations program with a single contact person or unit.** This person or unit would be responsible for fielding questions for continuing disclosure from the public, answering them on the web site, and keeping electronic disclosure information current.
- **Do not rely on implied consent to deliver documents electronically to investors.** The SEC believes that it would not be appropriate for issuers to rely on implied consent (which states that an investor has given implied consent to delivery of electronic disclosure information if he or she does not object to such delivery) because of the significant harm that could result through inadvertent failures to object. Instead, CDIAC advises issuers to get informed consent from investors. Thus, the investor would have to affirmatively accept electronic delivery of disclosure information.
- **Set up separate electronic disclosure and historical information sections of your web site.** Consider posting current continuing disclosure information to an electronic disclosure section on your web site and archiving outdated information to a historical section. Also consider using “as of” dates on historical information.
- **Consider the potential cost of posting documents to your web site in PDF form.** The SEC states that the use of the PDF format is acceptable but that issuers and underwriters inform investors of the requirements necessary to download PDF documents and provide technical assistance. Posting documents in both PDF and HTML formats would enable the investor to choose the format most convenient for him or her.
- **Consider using disclaimers and portal screens or eliminating hyperlinks to avoid investor confusion.** The SEC states that information on a web site would become part of an OS only if an issuer or underwriter acts to make it part of the OS. Consider using a portal screen (which is a page that appears before the user is launched into another web site) or changing the hyperlink to an Internet address that would have to be retyped or cut and pasted. Using a notice or disclaimer also could avoid investor confusion.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at <http://www.treasurer.ca.gov/stocda.htm>.

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